Transformational acquisition and Half Year ended 31 December 2016 results

28 February 2017

ASX & media announcement

Highlights

SCEE to acquire Heyday5 Pty Limited ("Heyday5") for an enterprise value of up to $54.1m:

- **Heyday5 is a leading east coast electrical contractor in the commercial and infrastructure markets**
- **Acquisition is a key milestone in SCEE's strategy to grow through expansion into adjacent and complementary sectors and new geographies**
- **Heyday5 is budgeted to achieve FY17 revenue of $152m and EBIT of $9.8m, delivering a step change in scale and immediate EPS accretion for SCEE**
- **Consideration is payable through $18m in cash on completion, $2.25m cash payable after FY17 results and further cash and SCEE share components subject to performance hurdles**
- **SCEE to maintain a strong balance sheet with cash of at least $25m and no debt post completion**
- **Heyday5 management to remain in the business**
- **Executive Director, David Hammond, to join SCEE Board**

SCEE H1 FY17 underlying revenue of $61.5m and net loss after tax of $2.8m *:

- **Activity in period negatively impacted by slower award of work in several sectors**
- **Significant restructuring and investment costs in period to drive future savings and growth**

Group guidance and outlook:

- **Forecast underlying NPAT of circa $4m for H2 FY17**
- **Current combined Group order book over $300m**
- **Anticipate combined Group revenue over $300m in FY18**

Overview

Southern Cross Electrical Engineering Limited ("SCEE") today announced that it has executed a Share Purchase Deed to acquire 100% of Heyday5 Pty Ltd ("Heyday5") for an enterprise value of up to $54.1m. Completion is expected to occur on 9 March 2017.

With a heritage dating back nearly 40 years, Heyday5 is a leading Sydney-based specialist electrical contractor. It has a strong position in the east coast commercial and infrastructure markets, supported by relationships with Tier 1 construction companies and property groups. Notable recent projects include the St George Hospital Redevelopment and Global Switch Data Centre. The business currently employs approximately 380 people across operations in New South Wales and the Australian Capital Territory.

Heyday5 is budgeting to deliver FY17 revenue of $152m and EBIT of $9.8m. The current order book of over $200m will support strong earnings into FY18.

** SCEE H1 FY17 Statutory and Underlying results reconciliation contained in Appendix*

Strategic rationale

The transaction is consistent with SCEE's strategy and delivers benefits for shareholders including:

- diversification across sectors and geographies, delivering immediate exposure to growing east coast commercial and infrastructure markets;
- potential to further leverage combined Group's customer relationships and skills into all geographies and sectors in which it operates;
- enhanced scale and financial backing, combined with SCEE's experience in major resources projects, unlocks further opportunities for the Group to pursue large scale upcoming infrastructure projects; and
- immediate and significant EPS accretion.

SCEE Managing Director, Graeme Dunn, said "This transformational acquisition is an important milestone in our strategy to grow into adjacent and complementary sectors and geographies. It gives us an immediate entry into the attractive Sydney and Canberra commercial and infrastructure markets and will open up exciting further opportunities for the combined group.

There is a strong cultural alignment between our businesses and I am delighted to welcome the Heyday5 team to SCEE."

Transaction terms

SCEE will pay the vendors of Heyday5 consideration of up to $54.1m on an enterprise value basis and the detailed transaction terms are set out in the Appendix.

The acquisition consideration represents EBIT multiples of:

- 4.2x FY17B assuming achievement of Heyday5 FY17 EBIT of $9.8m;
- 5.0x FY17B assuming Heyday5 maintains EBIT of $9.8m in each of FY18 and FY19; and
- 3.7x FY18 and FY19 EBIT assuming Heyday5 achieves earnings in FY18 and FY19 sufficient to receive full portion of outperformance earn-out consideration.

Cash payments will be funded through SCEE's existing cash reserves and earnings from the combined business.

Combined Group overview

The combined group will have a well-diversified portfolio of projects across Australia, with circa 55% of revenues generated from east coast operations. Revenue will also be spread across a range of industry sectors, including mining (19% of FY17B pro-forma revenue), oil & gas (13%), industrial, energy & utilities (6%), telecommunications & data centres (18%), commercial (27%), and public infrastructure and defence (17%).

Following completion, SCEE's combined order book will be over $300m.

At completion SCEE is expected to have a cash balance of at least $25m and no debt, with further liquidity to support ongoing growth through a $10m facility with CBA if required.

Advisers

Gresham Advisory Partners Limited is acting as financial adviser and K&L Gates is acting as Legal Adviser to SCEE on the acquisition.

SCEE H1 FY17 results

Revenue for the six months ended 31 December 2016 was $61.5m as activity in the period was negatively impacted by slower award of work in several sectors. Revenue for the prior comparative period ended 31 December 2015 was $137.1m which included significant contributions from several large scale mining construction contracts in the iron ore sector. Revenue decreased to $70.4m in the second half of the 2016 financial year as these iron ore construction contracts were completed. Gross margin for the six months ended 31 December 2016 was 11.9% compared to 13.1% in the prior corresponding period.

Operations in the period were carried out without incurring a Lost Time Injury.

Overheads for the half-year were $10.9m but included $1.2m of restructuring costs as management took further actions to ensure an efficient operating structure in a strongly cost focussed market and $0.6m of investment in progressing acquisition and diversification initiatives and the integration of the Datatel business. After adjusting for these amounts, the Group's underlying overheads for the half-year were $9.1m representing a 15.7% decrease from overheads of $10.8m in the prior corresponding period. Excluding Datatel's overhead, which was included for the first time in the current period, the reduction in comparative overheads was 29.6%.

Delays in WA NBN work have impacted on full year earnings expectations for Datatel. This has resulted in $1.6m being recognised in other income in the period from a reduction in the assessment of deferred consideration that will be payable under the terms of that acquisition. This revised assessment assumes that the base earn-out target will be achieved in FY17 and that the full stretch earn-out will be achieved in FY19, with growth in the interim period driven by east coast expansion.

Net loss after tax for the half-year was $2.9m compared to a net profit after tax of $3.8m in the prior corresponding period. After adjusting for the deferred consideration write-back and overhead items noted above, the underlying net loss after tax for the period was $2.8m.

Cash on hand at 31 December 2016 was $28.5m with no debt.

Outlook for the Merged Group

There is an expected increase in H2 FY17 revenue in SCEE's existing business compared to H1 FY17, based on the current order book and tendering activity. However the H2 FY17 result will be dependent on the winning and timing of award of certain construction projects in defence and public infrastructure sectors

Heyday5 is expected to at least meet its FY17 budget and the Group forecasts a profitable H2 FY17 with an underlying NPAT of circa $4m for the half.

The current combined order book of the Group is over $300m including approximately $30m of resources construction projects in final stages of approval. It is anticipated the order book will be maintained at the same or greater levels at 30 June 2017.

The combined Group revenue in FY18 is anticipated to be over $300m.

Appendix

Detailed Acquisition Terms

Acquisition	Acquisition of 100% of Heyday5 Pty Ltd Due diligence finalised Completion is expected to occur on 9 March 2017
Consideration	Up to a total of $54.1m payable as follows: **1. Initial Cash Consideration** $18m in cash at completion **2. Further Consideration** $2.25m in cash following release of SCEE's FY17 results **3. 2017 Results Consideration** Following confirmation that Heyday5's FY17 EBIT is equal to or greater than $9.8m: a) $7m in cash; and b) $13.85m in SCEE shares (refer to details below) If Heyday5's EBIT is less than $9.8m for FY17, elements (a) and (b) are both reduced on a pro-rata basis to nil at EBIT of $4.5m. **4. Earn-out: Deferred Consideration** – $4m in cash if Heyday5's EBIT result for FY18 is equal to or greater than 9.8m – $4m in cash if Heyday5's EBIT result for FY19 is equal to or greater than 9.8m **5. Earn-out: Outperformance Consideration** – 50% of EBIT in excess of $9.8m for the FY18 period, payable in cash and capped at $2.5m – 50% of EBIT in excess of $9.8m for the FY19 period, payable in cash and capped at $2.5m
Terms of SCEE Share issue	SCEE shares issued under 2017 Results Consideration will be ordinary fully paid shares in SCEE SCEE shares issued at the VWAP over the 10 trading day period commencing 5 trading days before announcement Subject to a maximum issue to the vendors of 19.9% of diluted shares on issue, with any shortfall to be paid by SCEE in cash 50% of SCEE shares will be escrowed for 12 months from their issue date, with the remaining 50% escrowed for 24 months from their issue date
Vendor involvement	Vendors that are currently executives of Heyday5 will continue in executive roles with SCEE post-completion David Hammond will join the SCEE Board

(Appendix continued.)

Appendix (continued)

SCEE Statutory and Underlying results reconciliations

H1 FY17 underlying profit reconciliation:

	Statutory $m	Organisation resturcturing $m	Acquisition, integration and diversification $m	Datael deferred consideration adjustments $m	Underlying trading (unaudited) $m
Contract revenue	61.5				61.5
Contract expenses	(54.1)	0.2			(53.9)
Gross profit	**7.3**	**0.2**			**7.5**
Other income	1.8			(1.6)	0.2
Overheads	(10.9)	1.2	0.6		(9.1)
EBITDA	(1.8)	1.4	0.6	(1.6)	(1.4)
Depreciation expense	(2.1)				(2.1)
EBIT	**(3.9)**	**1.4**	**0.6**	**(1.6)**	**(3.6)**
Net finance expense	(0.2)			0.2	0.0
Loss before tax	**(4.1)**	**1.4**	**0.6**	**(1.4)**	**(3.6)**
Income tax expense	1.2	(0.3)	(0.1)		0.8
Loss after tax	**(2.9)**	**1.1**	**0.5**	**(1.4)**	**(2.8)**

H2 FY16 underlying profit reconciliation:

Contract revenue	70.5		70.5
Contract expenses	(55.0)		(55.0)
Gross profit	**15.4**		**15.4**
Other income	0.1		0.1
Overheads	(11.0)	0.4	(10.6)
EBITDA	4.5	0.4	4.9
Depreciation expense	(2.5)		(2.5)
EBIT	**2.0**	**0.4**	**2.4**
Net finance expense	0.2		0.2
Profit before tax	**2.2**		**2.2**
Income tax expense	(0.9)	(0.1)	(1.0)
Profit from continuing operations	**1.3**	**0.3**	**1.6**

Contact

SCEE Perth Office
41 Macedonia Street
Naval Base WA 6165
T: +61 8 9236 8300

Graeme Dunn
CEO & Managing Director
E: graeme.dunn@scee.com.au

Colin Harper
Company Secretary
E: colin.harper@scee.com.au